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DIW Economic Outlook Spring 2025

63 Report by DIW Berlin's Economic Forecasting Team

Policy changes leaving marks on the economy

LEGAL AND EDITORIAL DETAILS

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AT A GLANCE

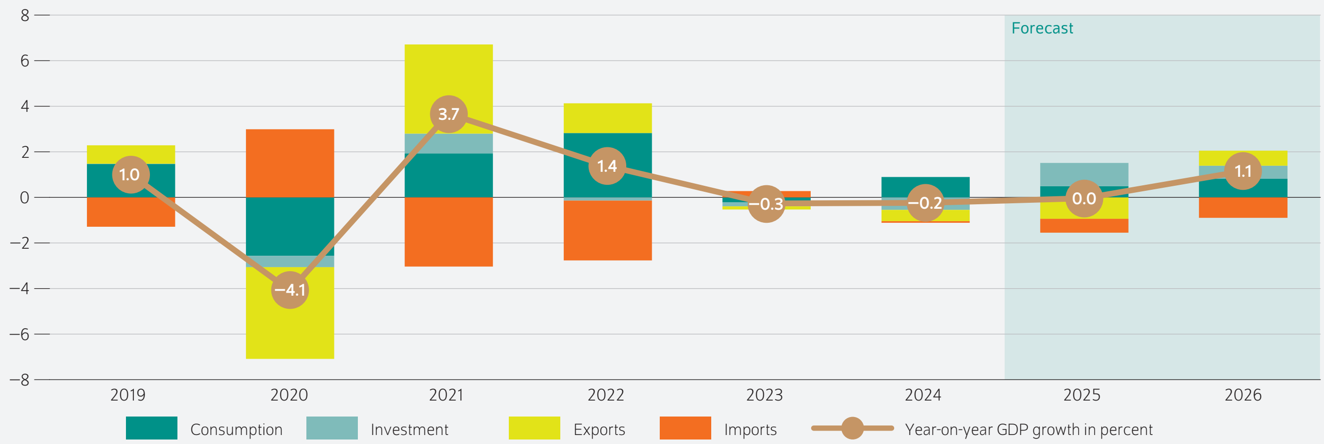
Policy changes leaving marks on the economy

By DIW Berlin's Economic Forecasting Team

- German economy stuck in a period of stagnation; no average annual growth is projected for 2025, the third consecutive year
- Weak exports, growing unemployment worries, subdued private consumption, and economic uncertainty are slowing the economy
- Gradual recovery can be expected from summer if a government is formed, the labor market becomes more stable, and private consumption picks up speed
- Interest rate cuts support investments and a special infrastructure fund is planned; thus, economic growth should be around two percent in 2026 and at 1.1 percent without additional investments
- Global economy remains on track, even if US trade policy is having a noticeable effect; growth projected to be 3.5 percent in 2025, barely below 2024 growth

German economy will not grow again until 2026; private consumption will then support the economy more than in 2025

Individual components' contribution to overall GDP growth in percentage points



Source: DIW Berlin Economic Outlook Spring 2025.

FROM THE AUTHORS

"If the planned special infrastructure fund and the additional defense funds actually happen, they would be a game changer for German industry and a positive signal for industry-related companies."

— Geraldine Dany-Knedlik —

MEDIA

Audio Interview with Geraldine Dany-Knedlik (in German)
www.diw.de/mediathek

Policy changes leaving marks on the economy

By Geraldine Dany-Knedlik, Guido Baldi, Nina Maria Brehl, Hella Engerer, Angelina Hackmann, Pia Hüttl, Konstantin A. Kholodilin, Frederik Kurcz, Laura Pagenhardt, Jan-Christopher Scherer, Teresa Schildmann, Hannah Magdalena Seidl, Ruben Staffa, and Kristin Trautmann

ABSTRACT

The German economy is stuck in a period of stagnation: Following two years of consecutive slight declines in GDP, growth is not expected for 2025 either. Weak exports, rising unemployment worries, and the resulting reserved private consumption and economic policy uncertainty are slowing the economy. Structural adjustment processes and the erratic trade policy of the Trump administration are weighing on German industry. A recovery, albeit gradual, is not expected until the summer. Once a government is formed, the economic policy framework will be clearer, the labor market will stabilize, and private consumption will pick up speed a little. Further interest rate cuts by the European Central Bank should support investment. In addition, the prospective upcoming government coalition of the CDU/CSU and the SPD has agreed on a special fund for infrastructure. Without this fund, the German economy is projected to grow by 1.1 percent in 2026, and with the fund, growth is expected to be a good two percent. The global economy has largely stayed on course so far, although current US trade policy is leaving noticeable marks. Despite this, global economic output is unlikely to grow less than in 2024, with 3.5-percent growth in 2025 and 3.6-percent growth in 2026.

Global economy braving times of political uncertainty

The global economy barely lost speed over 2024, expanding by 3.9 percent, similar to its growth in 2023 (Figure 1). The boom in the United States continued, which compensated for the sluggish upswing in many European countries that had been affected by the energy crisis in 2022 and 2023, such as Germany and France. Overall, the recovery in the euro area continued, mainly supported by purchasing power gains and stronger private consumption. The US economy experienced robust growth thanks to strong private consumption as well. However, general economic activity slowed slightly toward the end of 2024. Despite a number of expansionary economic policy measures, the Chinese domestic market remained weak; the Chinese government's five-percent growth target was only achieved due to strong foreign trade. The strong increase in Chinese exports can likely be attributed to them being pulled forward in response to the United States' tariff increases.

Following growth of 0.9 percent in the third quarter, the global economy picked up some speed in the fourth quarter of 2024 with growth of 1.1 percent. This should mainly be because of strong quarterly growth in China (1.6 percent) and Japan (0.7 percent), driven by strong exports that are partially fueled by anticipatory effects.[1] In India (1.5 percent) as well as Central and Southern European countries (1.0 percent), growth was also greater in the fourth quarter than the third quarter.

However, growing uncertainty about changes in policy direction in important economies, such as with the new Trump administration in the United States and the snap elections in Germany, dampened the economy in many places. For example, among the advanced economies, the US economy grew by only 0.6 percent in the fourth quarter, 0.2 percentage points less than in the third quarter (0.8 percent). Strong

1 Anticipatory effects can also be seen in seasonally-adjusted US data. For example, imports from China increased at the end of the year, cf. data on international trade on the U.S. Census Bureau website (available online; accessed on March 6, 2025. This applies to all other online sources in this report unless stated otherwise).

DOI: https://doi.org/10.18723/diw_dwr:2025-10-1

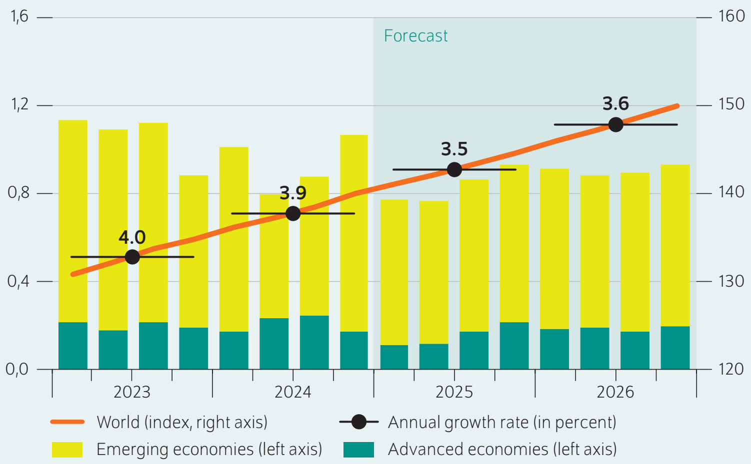
private and government consumption remained the main drivers of growth. In the euro area, growth also slowed down in the fourth quarter, only increasing by 0.2 percent following a 0.4-percent increase in the third quarter. This decrease was primarily due to weak economic output in Germany and France: The German economy contracted by 0.2 percent in the fourth quarter, performing the worst among the major euro area countries. France also slipped into the red at minus 0.1 percent as a result of a slowdown in private and public consumption. The Italian economy stagnated for the second quarter in a row. In contrast, the Spanish economy experienced robust growth of 0.8 percent. In Asia, South Korea grew by only 0.1 percent in the fourth quarter, the same as its third quarter growth. This sluggish performance can be explained by growing uncertainty among South Korean companies and private households combined with a loss of trust in response to political clashes over budget plans and the ensuing national crisis.

Some emerging economies also had lower quarter-on-quarter growth in the fourth quarter. In Brazil, the economy cooled down due to high interest rates, growing by 0.5 percent quarter-on-quarter. At minus 0.6 percent, the Mexican economy contracted in the fourth quarter after growth of 1.1 percent in the third. Trump's tariff threats led to a decline in foreign direct investments of companies that produce products for the US market in Mexico.

Figure 1

Real GDP growth

Quarter-on-quarter percentage growth (left axis); index 2015 Q1 = 100 (right axis)



Sources: National Statistical Offices; DIW Berlin Economic Outlook Spring 2025.

Due to growing trade barriers and major uncertainty, the global economy will not expand as strongly in 2025 as in past years.

Confidence has been increasing in industry worldwide since fall 2024. In contrast, sentiment among service providers has dipped since the end of 2024 in many places. As a result, companies have been a bit more pessimistic about the future overall. The Global Purchasing Managers' Index for manufacturing passed the expansion threshold of 50 index points in January 2025. At around 48 points, this index is slightly below the threshold in the euro area, but there, too, industrial sentiment has brightened considerably since the end of the year. Manufacturing companies in Japan and the United Kingdom have become slightly more pessimistic since the beginning of the year. The deteriorating sentiment in the services sector is most noticeable in the United States, where the Purchasing Managers' Index for the services sector has declined by nearly ten index points to just under 50 since the beginning of the year. The sentiment in the services sectors in the euro area, Japan, and China, in contrast, has only been dampened slightly.

So far, the second Trump administration's trade policy has been chaotic, characterized by threats, impositions, and re-impositions of drastic tariffs, even on close allies. The economic effects of this trade policy are already noticeable in the United States: Consumer confidence has declined markedly since Trump's inauguration and the stock markets have also suffered significant losses. The average tariff rate on Chinese goods imports was raised by a total of 20 percentage points. Tariff rates on Canadian and Mexican imports were also increased considerably. While there are currently exemptions for goods that comply with the North American free trade deal, a 25-percent import tariff could be implemented on all Canadian and Mexican imports from the beginning of April.

This forecast assumes that the United States' tariff policy will remain as is and that any exemptions are only short term, as announced. This forecast does not include threats like universal 25-percent tariffs on European goods imports into the United States, but such threats do represent a significant risk. In addition to the tariffs announced to date, the erratic and contradictory communication of US trade policy is increasingly stirring up uncertainty, particularly among businesses.

Significant cooldown expected in the US during the first quarter

US trade policy and greater political uncertainty will likely dampen the global economy in the first half of 2025. Accordingly, global economic output is expected to grow by only 0.8 percent in the first quarter. Economic output among the advanced economies will likely increase by only 0.2 percent and slowly pick up speed over the course of the year. This slowdown is primarily due to the economic slowdown in the United States as a result of the significant tariff increases on Canadian and Chinese imports. In the current quarter, economic growth in the United States will be dampened by a considerable slowdown in private consumption. Above all, the hefty rise in inflation expectations is weighing on household sentiment. Greater uncertainty due to the unpredictable US trade policy will likely delay corporate investments. The Japanese economy is expected to grow in the first quarter, even if at a lower rate compared to the fourth quarter of

Box

Assumptions and framework conditions

This forecast is based on assumptions on the development of key interest rates, exchange rates, and raw material prices (Table). These assumptions were made based on previous developments, futures markets prices, and the closing prices on the date of this forecast (February 14, 2025).

Inflation in the euro area has continued to slow, essentially developing in line with the European Central Bank's (ECB) projections. Following a further interest rate cut of 25 basis points by the European Central Bank (ECB) in March, it is assumed that it will continue on this path and make two further interest rate cuts of 25 basis points each. By the end of the cuts in summer, the deposit rate should be two percent.

In line with key interest rates, money market interest rates should continue to decline. Falling refinancing costs for companies and falling borrowing costs for households reflect the normalization of monetary policy. This forecast assumes that these personal loan interest rates will continue to fall in line with the loosening of monetary policy. The yields on ten-year government bonds increased slightly at the end of 2024, with the interest rate difference between the ten-year German and ten-year euro area government bonds remaining stable. We assume that capital market interest rates will remain largely unchanged over the forecast horizon at 2.5 percent for Germany and 3.1 percent for the euro area.

The euro has appreciated slightly against the US dollar compared to the fourth quarter of 2024. For the forecast period, it is assumed that the exchange rate of EUR to USD will remain at 1.05 USD per EUR, the level reached at the end of the data period. According to traded futures, the price for Brent oil should increase slightly in the coming months before declining again from 2026 until the end of the forecast period. In 2025, the average price should be 75 USD per barrel before declining to 71 USD per barrel in 2026. The wholesale price for gas (TTF) rose over the course of 2024. In 2025, it is likely to average 51 euros per megawatt hour before falling in the fourth quarter of 2025 and over the course of 2026. In 2026, it is likely to be 41 euros per megawatt hour. A cold winter; the expiration of a transit agreement with Gazprom; and empty gas storage facilities, which must be filled to the legally required levels by November, will lead to upward pressure on prices in 2025. In 2026, additional supply capacities are expected from Qatar, for example, which should ease the situation on the European gas market. This forecast is also based on trade policy assumptions.

Table

Forecast assumptions

		2023	2024	2025	2026
ECB deposit rate[1] (year end)	Percent	4.0	3.0	2.0	2.0
ECB key interest rate (year end)	Percent	4.5	3.15	2.15	2.15
Money market interest rate	Three-month EURIBOR in percent	3.4	3.6	2.1	2.0
Capital market interest	Yield on euro-area government bonds with a remaining term of ten years	3.3	3.0	3.1	3.1
Capital market interest	Yield on German government bonds with a remaining term of ten years	2.6	2.4	2.5	2.5
Exchange rate	USD/EUR	1.08	1.08	1.05	1.05
Crude oil price	USD per barrel	82.5	80.5	74.5	70.7
Gas price	EUR per megawatt hour	42.1	34.5	51.2	40.9

1 The ECB is currently steering the economy via the deposit facility, not the main refinancing rate (key interest rate).

Note: Annual average unless indicated otherwise.

Sources: European Central Bank; European Money Markets Institute (EMMI); Eurex Exchange; Deutsche Bundesbank; Federal Reserve; Energy Information Administration (EIA); Intercontinental Exchange (ICE); CME Group; DIW Berlin Economic Forecast Spring 2025.

2024. A positive balance of exports and imports as well as purchasing power gains (due to falling inflation and high nominal wage agreements in 2024) continue to support the Japanese economy.

After the setback in the fourth quarter, the recovery in the euro area is picking up speed again, supported by private consumption and a robust labor market. The euro area economies are growing at differing paces: Spain is experiencing especially strong growth due to low energy price increases and a simultaneous sharp rise in nominal wages. The French economy should expand by 0.2 percent in the first quarter of 2025, with growth due to anticipatory exports to the United States. The German economy, in contrast, is not likely to expand in the first quarter. Due to dampened domestic demand, the UK economy will only increase by 0.1 percent.

The emerging economies should grow by 1.0 percent in the first quarter of 2025, with India and China in particular contributing positively to growth. In China, this is primarily due to expansive monetary and fiscal policy as well as sustained investments in the high-tech sector, which should at least partially counteract the real economic distortions caused by US tariffs over the course of 2025.

The global monetary policy this year should be less restrictive and thus no longer slow economic growth. The central banks of many advanced economies, such as the European Central Bank (ECB) or the Bank of England, will make the final interest rate cuts this year for the time being (Box), as inflation rates will likely stabilize at a lower level again. This development is supported by moderately increasing food prices and declining energy prices in many places. In the euro area, the inflation rate should level off at the ECB's two-percent target this year. In contrast, the inflation rate in the United States remains quite high and was 2.8 percent as of February 2025. Due to the significant tariff hikes on China, Mexico, and Canada, price pressure should continue

Table 1

Real GDP, consumer prices, and unemployment rate in the global economy
In percent

	GDP				Consumer prices				Unemployment rate in percent			
	Year-on-year percentage change											
	2023	2024	2025	2026	2023	2024	2025	2026	2023	2024	2025	2026
Europe												
European Union	0.6	1.0	1.5	1.8	6.4	2.6	2.4	2.3	6.0	6.0	5.8	5.7
Euro area	0.5	0.8	1.1	1.3	5.4	2.4	2.1	1.9	6.6	6.4	6.2	6.1
excluding Germany	1.2	1.4	1.3	1.5	5.0	2.2	2.0	1.9	8.3	7.8	7.6	7.6
France	1.1	1.1	0.8	1.4	5.7	2.3	1.8	1.8	7.3	7.4	7.4	7.5
Italy	0.8	0.5	0.8	1.0	5.9	1.1	1.9	2.0	7.7	6.5	6.5	6.4
Spain	2.7	3.2	2.5	2.1	3.4	2.9	2.3	1.9	12.2	11.3	10.5	10.2
Netherlands	0.1	0.9	2.1	1.8	4.1	3.2	2.4	2.0	3.6	3.7	3.6	3.6
United Kingdom	0.4	0.9	0.8	1.5	7.3	2.5	2.6	2.1	4.1	4.3	4.4	4.1
Switzerland	0.7	1.3	1.4	1.7	2.1	1.1	0.3	1.1	4.0	4.4	4.7	4.3
Central and Southeastern Europe	0.5	1.9	2.9	3.2	11.5	4.0	3.4	3.1	3.6	3.7	3.5	3.4
Turkey	5.1	3.0	2.7	3.3	54.0	58.5	35.6	29.8	9.4	8.7	8.7	8.6
Russia[1]	3.3	4.1	1.6	1.0	5.9	8.5	6.8	4.6	3.2	2.5	2.4	2.4
The Americas												
USA	2.9	2.8	1.8	2.0	4.1	3.0	3.5	2.8	3.6	4.0	4.0	3.9
Mexico	3.3	1.3	-0.3	0.1	5.5	4.7	4.1	3.2	2.8	2.7	2.9	3.0
Brazil	3.2	3.1	2.3	2.0	4.6	4.4	3.9	3.1	8.0	6.9	6.8	6.9
Asia												
Japan	1.5	0.1	1.1	0.9	3.3	2.7	2.4	1.6	2.6	2.5	2.4	2.2
South Korea	1.4	2.1	1.8	2.2	3.6	2.3	1.8	1.9	2.7	2.8	3.0	3.0
China	5.2	5.0	4.5	4.3	-1.7	0.0	0.8	1.1	5.2	5.1	5.0	5.0
India	7.8	6.1	6.3	6.5	5.7	4.9	5.4	4.1	8.1	8.0	7.9	7.7
Total												
Advanced economies	1.8	1.8	1.5	1.7	4.6	3.3	3.3	2.7	4.4	4.5	4.4	4.3
Emerging economies	5.5	4.9	4.5	4.5	4.2	5.7	5.3	4.7	6.2	6.0	5.9	5.8
Global economy	4.0	3.9	3.5	3.6	4.2	3.9	4.0	3.4	5.8	5.7	5.6	5.5
For reference:												
Export weighted[2]	*3.0*	*2.9*	*2.5*	*2.7*								
GDP weighted in USD[3]	*3.3*	*3.2*	*3.0*	*2.9*								

1 The growth rate for GDP in the euro area are adjusted for calendar as well as seasonal effects.
2 The data forecast for Russia are subject to major uncertainties. Russia has only minor weight in the overall forecast.
3 World weighted with shares of German exports from 2024.
4 World weighted with the GDP in USD from 2023 to 2026.

Notes: The black figures are finalized. The values of the groups of countries are a weighted average, with the respective GDP in purchasing power parities from the IMF World Economic Outlook for 2023 to 2026 used to weight GDP and consumer prices. The 2023 labor force (15–64 years old) figures of the respective countries are used to weigh the unemployment rate in the groups of countries. Central and Eastern Europe consist of Poland, Romania, Czechia, and Hungary in this forecast.

Sources: National Statistical Offices; DIW Berlin Economic Outlook Spring 2025.

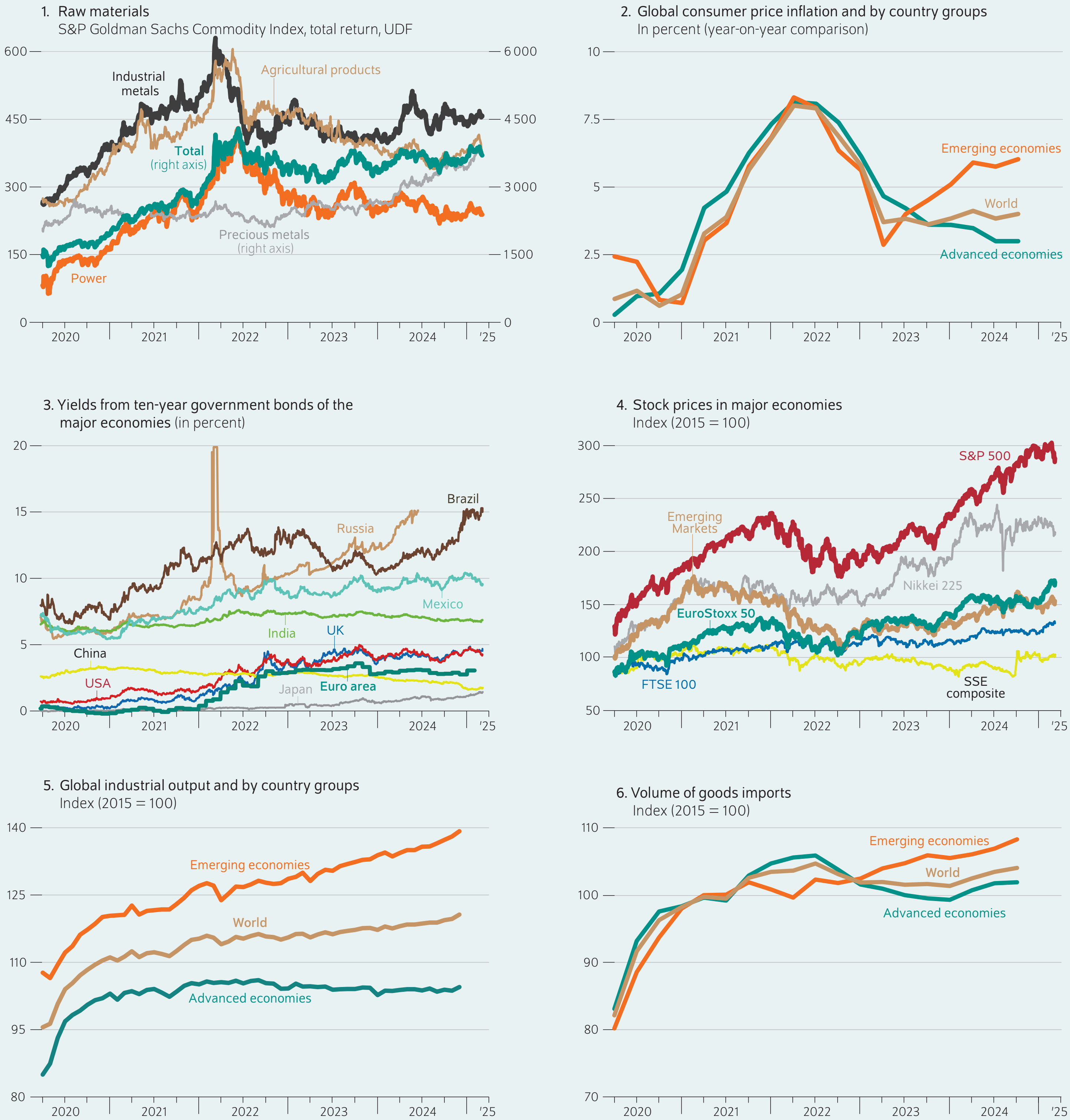
to increase in 2025 and not decline until 2026. The labor shortage will also likely lead to upward pressure on prices. This forecast expects that the US Federal Reserve will not make any further interest rate cuts until the summer. The Bank of Japan, in contrast, is sticking to its restrictive course and raised the key interest rate from 0.25 to 0.5 percent in January. Due to deflationary tendencies, the Chinese central bank is continuing to follow a loose monetary policy.

Fiscal policy is slightly expansionary in most economies. Government debt is expected to increase in the United States in particular due to planned extensions to tax rate reductions for corporations and households from Trump's first term as well as high military expenditure. The wave of public sector layoffs should make government debt somewhat lower. The United Kingdom's fiscal policy is expected to be expansionary as a result of the Labour government's autumn budget. Fiscal policy in the euro area, in contrast, should remain moderately restrictive over the forecast period; some Member States, such as Italy, must continue their efforts to reduce their budget deficit. Due to geopolitical developments, EU subsidies for military expenditure and exemptions from the European debt criteria for this expenditure are currently under discussion, but they are not considered in this forecast.

Global uncertainty has increased considerably since the beginning of winter due to geopolitical crises and the US's erratic trade policy. Some media-based uncertainty indices are now significantly above the level that was reached during the coronavirus pandemic, especially in economies near

Figure 2

Global economic environment indicators



Notes: Last observations: March 4, 2024 (part 1 of figure); December 31, 2024 (part 2 of figure); March 5, 2025 (part 3 of figure); March 5, 2025 (part 4 of figure); December 1, 2024 (part 5 of figure); December 31, 2024 (part 6 of figure).

Sources: S&P Dow Jones Indices; Deutsche Börse; CBOE; EZB; PBoC; Federal Reserve; BoE; BOJ; Central Bank of Brazil; Bureau of Labor Statistics; IHS Markit; and CPB Word Trade Monitor.

the geopolitical crises. The stock markets also experienced a slump at the beginning of March (Figure 2). The considerable increase in uncertainty as well as growing trade barriers should weigh on corporate investment activity and thus delay the recovery of international trade in the second half of 2025. Overall, international trade should increase by 2.1 percent in 2025 and by 2.0 percent in 2026.

US trade policy will slow down the global economy in 2025 and 2026

The pace of global economic expansion is expected to decline over the further course of the forecast. Growing trade barriers are slowing the economies of the affected countries. In the United States, it is expected that Trump's trade policy and the related uncertainty will result in private consumption cooling down and fewer corporate investments. While the recovery in the euro area will pick up speed over the course of the year, no major growth is expected. Further purchasing power gains, together with a gradual recovery in the manufacturing industry and favorable refinancing conditions, should boost the domestic market. More uncertainty and growing trade barriers are weighing on the European economy, but tariff asymmetries and thus an increase in trade volumes with North America should likely offset the negative consequences. The UK economy will also likely continue its upturn beyond the forecast horizon, with the country's expansionary fiscal policy supporting demand.

Due to the latest US tariff policy, the outlook for emerging economies has deteriorated: China in particular is likely to suffer from the slowdown in foreign trade, which will probably cause the Chinese economy to slow down as well. Higher tariffs and the resulting expected appreciation of the US dollar should weigh on economic output in many emerging economies. Due to higher tariffs, they will probably expect less foreign direct investment.

In 2025, advanced economies are projected to grow by 1.5 percent and emerging economies by 4.5 percent (Table 1). A growth rate of 3.5 percent is expected for the global economy in 2025, while growth of 3.6 percent is expected for 2026. Despite an increase in trade barriers and political distortions, the forecast for 2025 and 2026 is only 0.1 percentage points lower each than the 2024 winter forecast.

The forecast for the global economy currently remains subject to considerable uncertainty. First, there is a high risk that US trade policy will become even more protectionist than expected in this forecast, for example by increasing a sweeping 25-percent tariff on all EU imports. If such a tariff is introduced, it could cause significant distortions in the global economy. Higher tariffs would also put more pressure on prices in the United States than expected, which would likely result in higher interest rates and lower growth. If Trump then undermines the independence of the US Federal Reserve, it could result in global turbulence on the financial markets.[2] As real economic effects of Trump's tariff policy are already becoming noticeable in the United States, the administration may still pause or suspend existing tariffs. This would limit real economic effects and economic output in North America would be higher than expected in this forecast.

Second, geopolitical risks have also grown. The United States' distancing itself from support of Ukraine and Europe has refined the geopolitical world order. If this then leads to increases in defense spending in Europe, European fiscal policy would be much more expansionary than assumed and economic output would be significantly higher than forecast here. However, further escalation in the Middle East could cause the global economy to grow more slowly than forecast due to a sharp rise in oil and gas prices. Falling energy prices pose an upside risk, as the United States was able to increase the supply of gas and oil by withdrawing from the Paris Agreement. However, this does not take long-term negative consequences for climate change into account.

2 Cf. Warwick J. McKibbin, Megan Hogan, and Marcus Noland, "International Economic Implications of a Second Trump Presidency," Working Papers 24-20 (2024: Peterson Institute for International Economics) (available online).

German economy stuck in stagnation

Snap elections and the upcoming formation of a new German federal government as well as the United States' recent shift in trade and geopolitical policy are causing uncertainty to grow. This uncertainty is in turn affecting the German economy in its already fragile state.[3] The industrial sector has not recovered fully since the coronavirus pandemic for both structural as well as cyclical reasons, such as tougher international competition, higher energy prices, and the skilled worker shortage. In 2024, the German economy contracted for the second year in a row and is thus, by definition, in a recession. However, with a decline in GDP of 0.3 percent in 2023 and of 0.2 percent in 2024, the German economy rather seems to be stuck in a prolonged period of stagnation (Figure 3). Since January 2025, the Trump administration has made it clear that the United States is no longer a reliable economic or geopolitical partner for Europe. The economic policy envisaged by the former coalition government last fall (which, due to the imminent formation of a new government, is the assumption underlying this forecast), will not noticeably boost growth in Germany. The investments in infrastructure announced by the CDU/CSU and SPD during their exploratory talks and the relaxing of the debt brake for defense spending could set the course for growth; infrastructure investments would, if implemented, result in noticeable growth, although not until the end of 2025 at the earliest. However, the funding for this could also moderately increase inflationary pressure.[4]

The German economy is continuing to sputter for the time being: Economic output contracted again by 0.2 percent in the final quarter of 2024 (Table 2). The situation was particularly dire for German foreign trade: In the fourth quarter, quarter-on-quarter goods exports declined considerably for the second time in a row. A continued sharp fall in demand from China and the United States weighed on German goods exports. In particular, the automobile industry suffered significant declines in sales in both markets. Less dramatic but still noticeable was the decline in exports of German mechanical engineering companies. Thus, exporting industrial companies continue to be weakened, confronted with declining competitiveness and increasing competition from abroad. The brittle performance of German exports to non-European countries was cushioned by a moderate increase in exports to the rest of Europe, which account for around half of German exports overall. At the same time, imports increased somewhat, primarily due to strong service imports, resulting in a negative trade balance.

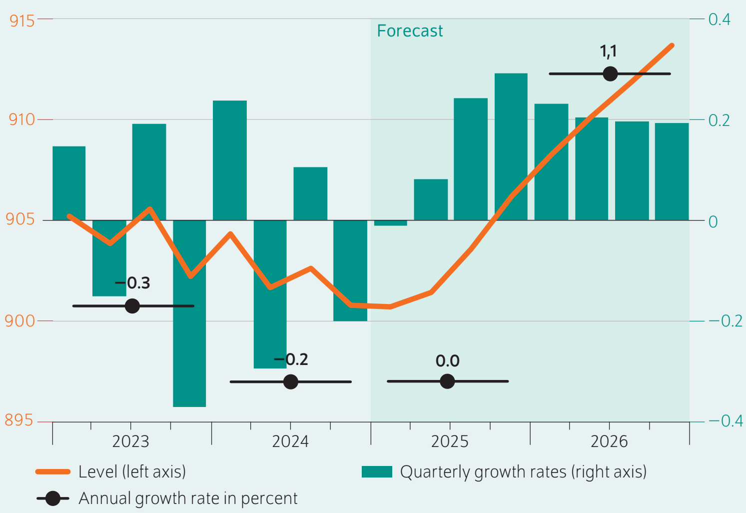
Although higher domestic demand offset weak foreign trade in the fourth quarter, this was mainly because many goods were produced for stock. Meanwhile, consumption and investments barely supported overall economic output (Figure 4). Gross fixed capital formation increased slightly: While investment in equipment declined again, investment in construction experienced a surprisingly strong expansion. This may be due to the mild weather in late fall; commercial construction investment, which has a large share of weather-dependent civil construction, grew considerably. Private consumption also increased somewhat, but growth remained subdued. While inflation has stabilized recently and real wages experienced powerful growth in 2024, these purchasing power gains were barely noticed, due to the poor economic situation and the higher price level compared to pre-crisis times. Thus, private households refrained from larger purchases at the end of 2024. Economic output was stabilized by the public sector: Both public consumption and public investments increased noticeably in the final quarter of 2024. This is mainly due to expenditure as a part of the special fund for the *Bundeswehr* as well as growth in public sector employment.

The poor economic situation is reflected more and more on the labor market, which increases private households' worries about job losses. Overall, employment growth has come to a halt (Table 3). While an increase was recorded in the public sector, the number of employees in industrial production and in business-related services has fallen noticeably. Unemployment rose further at the end of the year, with the strongest increase in long-term unemployment. The

Figure 3

Real GDP growth in Germany

In billions of euros (left axis) and quarter-on-quarter growth in percent (right axis)



Notes: Forecast from the first quarter of 2025; adjusted for price, seasonal, and calendar effects.

Sources: Federal Statistical Office, DIW Berlin Economic Outlook Spring 2025.

The German economy will begin to grow again somewhat from summer 2025.

3 This forecast is based on the latest available data (March 10, 2025). More detailed figures for the German economy can be found online: www.diw.de/konjunkturzahlen.

4 Cf. Geraldine Dany-Knedlik, Alexander Kriwoluzky, and Malte Rieth, "Sondervermögen für Infrastruktur: 500-Milliarden-Euro-Investitionspaket würde deutsche Wirtschaft aus der Krise holen," *DIW aktuell* no. 111 (2025) (in German; available online).

Table 2

Quarterly data on the development of expenditure and production components of real GDP in Germany
In percent (quarter-on-quarter, seasonally and calendar adjusted)

	2024				2025				2026			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Private consumption	0.2	−0.1	0.2	0.1	0.0	0.1	0.3	0.3	0.3	0.3	0.2	0.2
Public consumption expenditure	0.1	1.9	1.5	0.4	−0.5	0.1	0.3	0.3	0.2	0.2	0.2	0.3
Gross facilities investment	0.3	−2.0	−0.5	0.4	0.2	0.3	0.4	0.5	0.6	0.6	0.6	0.6
Construction	0.7	−2.1	−0.5	1.0	−0.4	0.2	0.1	0.3	0.4	0.4	0.5	0.6
Equipment	−0.8	−3.2	−1.2	−0.3	0.9	0.1	0.5	0.7	0.8	0.8	0.9	0.8
Other investment	1.4	0.6	0.6	−0.2	0.6	0.7	0.9	0.7	0.7	0.6	0.5	0.4
Inventory changes1	−0.2	0.2	0.8	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic consumption	0.1	0.1	1.2	1.0	−0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Net exports	0.2	−0.4	−1.1	−1.2	0.0	−0.1	0.0	0.0	−0.1	−0.1	−0.1	−0.1
Exports	1.5	0.2	−1.9	−2.2	0.4	0.0	0.2	0.3	0.3	0.3	0.3	0.3
Imports	1.1	1.2	0.6	0.5	0.3	0.2	0.3	0.4	0.5	0.5	0.6	0.5
GDP	0.2	−0.3	0.1	−0.2	0.0	0.1	0.2	0.3	0.2	0.2	0.2	0.2
Gross value added	−0.4	−0.3	−0.4	−0.3	0.0	0.1	0.2	0.3	0.2	0.2	0.2	0.2
Manufacturing	−0.1	−0.7	−1.4	−0.6	0.0	0.0	0.2	0.3	0.2	0.2	0.2	0.2
Construction	2.3	−3.2	−1.3	−0.9	−0.3	0.2	0.3	0.4	0.4	0.4	0.4	0.5
Trade, hospitality, transport	0.5	−0.8	−0.1	0.5	0.1	0.2	0.3	0.4	0.3	0.3	0.2	0.2
Professional services provider	−0.3	0.2	−0.6	−0.3	−0.2	0.0	0.2	0.3	0.2	0.2	0.1	0.1
Public services, education, health	0.5	0.4	1.4	0.3	0.1	0.1	0.2	0.2	0.1	0.1	0.1	0.1

1 Contribution to growth in percentage points.

Note: Forecast from the first quarter of 2025.

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Spring 2025.

bad signs from the labor market likely have prompted private households that can afford it to save a considerable part of their income as a safety net: The savings rate adjusted for seasonal effects remained high, at 11.5 percent.

The labor market situation reflects the production declines in the industrial sector. The manufacturing industry recorded its seventh consecutive decline in the fourth quarter of 2024, and the construction industry also saw a further drop in production. The industrial recession is increasingly spilling over into business-related service providers, which also reported lower value added. In contrast, the value added of consumer-related and public service providers increased slightly in the fourth quarter of 2024, somewhat stabilizing gross value added overall. However, the value added was 0.3 percent lower than in the third quarter.

Uncertainty continuing to slow the economy in the first quarter

The new German government will be facing major challenges with the loss of the United States as a reliable political partner. The question of how to approach these challenges in detail creates continuing uncertainty in regard to the economic policy conditions in Germany. As expected, US President Donald Trump is following an aggressive trade policy that threatens to turn global trade upside down. While many of the tariffs may only be used as bargaining chips, potential import duties on cars and pharmaceutical products, for example, threaten the economic viability and reduce the ability of German (export) companies to plan future business (Box). In addition, Germany, due to the United States' switch in foreign policy direction, must become more independent from the United States in terms of security policy. For example, the potential coalition partners, the CDU/CSU and the SPD, announced in March a plan to exempt defense expenditure over one percent of GDP from the debt brake rules.[5] At the same time, the EU Commission has signaled that the European fiscal rules for military expenditure should be relaxed. In addition, the potential future federal government is planning a special fund for infrastructure investment in the amount of 500 billion euros. Altogether, this indicates a historic level of expenditure on public investments. However, as these measures had not yet been passed at the time of this forecast, the forecast is based on the fiscal policy from the previous government's budget plan from fall 2024. The potential effects of the special fund for infrastructure on GDP, private investments, and inflation are estimated in a separate DIW Berlin study.[6]

Sentiment in the manufacturing industry has improved somewhat since fall 2024. For example, the Purchasing Managers' Index for the manufacturing industry has increased noticeably, by six index points, since September. However, as of February 2025 it was still under the expansion threshold of

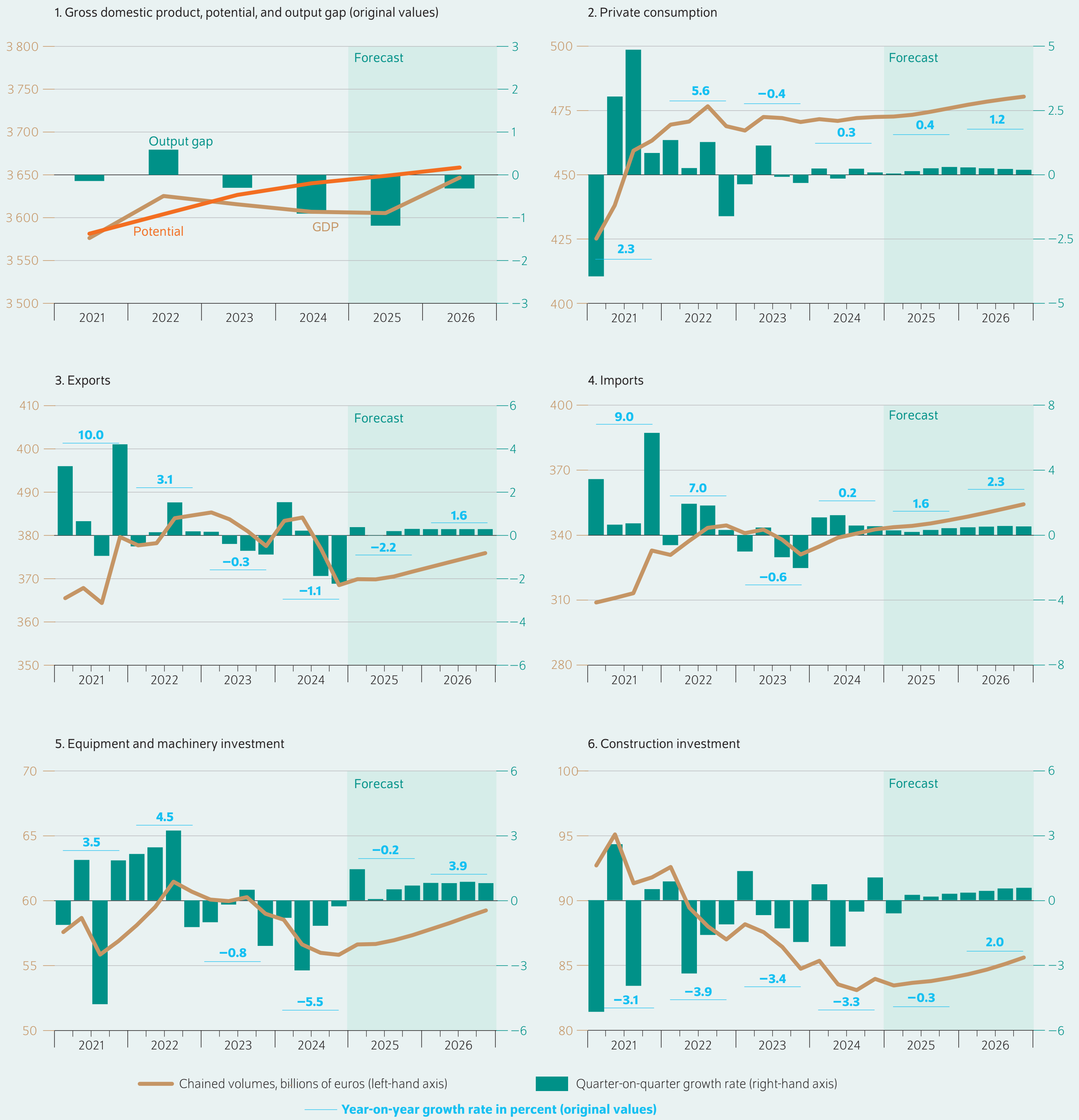
5 CDU, CSU, and SPD, *Ergebnisse der Sondierungen* (2025) (in German; available online).

6 Cf. Dany-Knedlik, Kriwoluzky, and Rieth, "Sondervermögen für Infrastruktur."

Figure 4

GDP and important components

Seasonally, calendar, and price-adjusted development



Note: Forecast from the first quarter of 2025; adjusted for price, seasonal, and calendar effects.

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Spring 2025.

50 points at around 46 points. Sentiment among service providers, in contrast, has recently deteriorated a little.

Despite the somewhat improved sentiment overall, predominantly foreign and domestic political uncertainties are thwarting economic development in the current quarter. The manufacturing industry will only pick up modestly. The service sectors are unlikely to contribute to growth in value added. Labor market indicators suggest that employment will decline while unemployment should continue to slightly increase initially. While wages may rise,[7] they will do so at lower rates than in 2024. Inflation should continue to stabilize, in part due to the slight decline in energy prices. Overall, it is expected that private households' purchasing power will continue to increase, although to a lesser degree than previously. However, this is unlikely to translate directly into growth in private consumption; currently, people are too uncertain and will probably continue to save their money for the time being. Accordingly, the savings rate should remain markedly high. Due to the provisional budget still in effect, government consumption will probably temporarily lose some momentum, dampening GDP.

In addition to sluggish growth in private consumption, private investment is also struggling to grow. Strong growth at the end of 2024 due to non-recurring effects made momentum in the construction industry seem stronger than it is, meaning that low growth is expected for the first three months of 2025. While the decline in residential construction should be more moderate, the icy temperatures in February may have delayed civil engineering production in particular, and thus primarily commercial construction investment, which recently stabilized overall development. Slight positive growth is currently expected from equipment investment. There, incoming orders increased considerably in December, indicating growth for the first quarter of 2025, partially supported by strong public sector demand. Goods imports should benefit from this and will likely increase somewhat at the beginning of 2025, causing overall imports to rise. Exports, too, should recover slightly following sharp declines over the past six months. The German export industry could benefit from an increase in corporate investment in other European countries. According to statistics from the ECB, demand for corporate loans there has recently recovered somewhat. However, as exports and imports are expected to grow at similar rates, net exports are unlikely to have either a positive or negative impact on economic output in the first quarter of 2025 (Table 4).

Gradual recovery beginning in the summer

The economic situation is expected to gradually improve over the coming months. For this to happen, corporate and private household sentiment must continue to brighten as a result of clear economic conditions in Germany. Private consumption will grow again somewhat, when the labor market stabilizes slightly (rising employment and declining unemployment figures), as households are spending at least some of their savings. At the same time, real wage increases are expected to be of smaller magnitude than in 2024, resulting in consumer spending continuing to develop rather reservedly in a historical comparison.

Table 3

Key economic indicators for the German economy

	2024	2025	2026
GDP[1]	−0.2	0.0	1.1
Employment[2] (1,000 persons)	46,082	46,041	46,071
Unemployed (1,000 persons)	2,787	2,898	2,874
Unemployment rate[3] (BA concept, in percent)	6.0	6.2	6.1
Consumer prices[4]	2.2	2.1	2.0
Unit labor costs[5]	5.5	3.2	1.8
Government budget balance[6]			
in billions of euros	−118.8	−107.0	−101.7
in percent of nominal GDP	−2.8	−2.4	−2.3
Current account balance			
in billions of euros	248.7	193.2	186.6
in percent of nominal GDP	5.8	4.4	4.1

1 Price adjusted. Year-on-year change in percent.
2 Domestic concept.
3 Unemployed as a percentage of the civilian labor force (definition according to the Federal Employment Agency).
4 Year-on-year change.
5 Compensation of employees per hour worked in Germany as a percentage of real GDP per hour worked.
6 As defined in the national accounts (*volkswirtschaftliche Gesamtrechnungen*).

Note: Forecast for 2025 and onward.

Sources: Federal Statistical Office; Federal Employment Agency; DIW Berlin Economic Outlook Spring 2025.

Table 4

Contributions to change in GDP in Germany

In percentage points (price-adjusted)

	2024	2025	2026
Consumption	0.9	0.5	0.8
Private households	0.1	0.2	0.6
Government	0.8	0.3	0.2
Gross facilities investment	−0.5	0.0	0.5
Construction	−0.3	0.0	0.2
Equipment	−0.4	0.0	0.2
Other facilities	0.2	0.1	0.1
Inventory changes	0.0	1.0	0.0
Domestic consumption	0.3	1.5	1.4
Net exports	−0.6	−1.5	−0.2
Exports	−0.5	−0.9	0.7
Imports	−0.1	−0.6	−0.9
Gross domestic product[2]	**−0.2**	**0.0**	**1.1**

1 Use aggregates minus import content.
2 Year-on-year change in percent; any deviation in the totals is due to the rounding of the figures.

Note: Forecast from the first quarter of 2025.

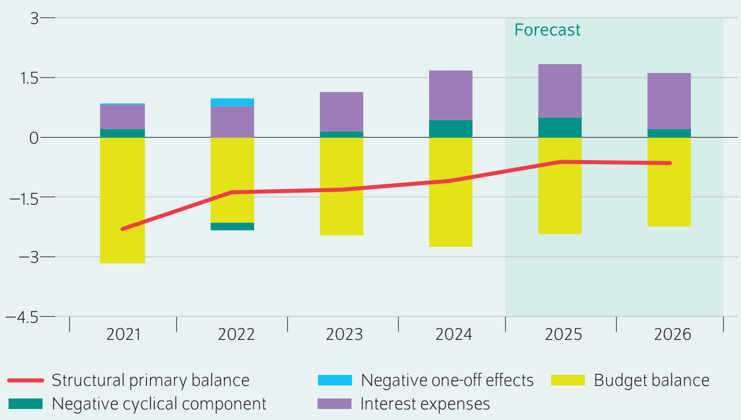
Sources: Federal Statistical Office; DIW Berlin calculations; DIW Berlin Economic Outlook Spring 2025.

7 At the beginning of 2025, collective bargaining for more than 2.6 million federal and municipal employees expired. The unions are demanding an eight-percent increase in pay, but at least 350 euros per month for a period of 12 months.

Figure 5

Structural primary balance

In percent (relative to nominal production potential)



Note: The structural primary balance is the sum of the columns. Forecast from 2025 onward.

Sources: Federal Statistical Office; DIW Berlin Economic Forecast Spring 2025.

The structural primary balance is still negative.

Despite falling interest rates, monetary policy is expected to remain restrictive in 2025. We assume that the neutral interest rate will be reached around mid-2026. The favorable financing conditions are supporting the development of investment activity. Construction investment seems to have weathered its nadir and should gradually increase again over the course of the forecast. While investments in infrastructure should continue to be stable and support construction activity overall, a slight recovery in residential construction is also expected. There, the incoming orders have recently stabilized at a low level and there is a slight upward trend in new lending. Stable price developments should also boost demand. Equipment investment will probably also increase somewhat from the second half of the year. This will continue to be determined by government expenditure and, in particular, by the special fund for the *Bundeswehr*, whose impact should increase over the coming years.

Excluding major growth stimuli from the public sector in the form of infrastructure and defense orders, the structural changes resulting from tougher competition, higher energy prices, and demographic changes are likely to slow the recovery of the German economy over the course of the forecast. This will probably affect the manufacturing industry and business-related service providers in particular, which should only gain growth momentum slowly in light of the gradual recovery in global industrial production.[8] As a result, foreign trade will continue to stagnate. German imports should stabilize and benefit from the upturn in corporate investment, especially in other European countries. However, with rampant protectionism and the further decline in the competitiveness of German companies—particularly compared to Chinese producers in the manufacturing industry—it is unlikely that the domestic export industry will regain its former strength. Overall, foreign trade should weigh on economic growth slightly in the coming months.

Without the special fund for infrastructure and higher defense spending, fiscal policy is assumed to be moderately restrictive over the entire forecast period. Fiscal policy should also have a slight negative effect on GDP, with companies in particular being burdened, for example due to the increase in the carbon price in emissions trading and the expiration of depreciation rules that favor investments. In regard to households, the effect of the fiscal measures is heterogenous: Low-income households are barely affected, while high-income households benefit slightly, in particular from the shift in income tax rates. However, they will be hit harder by the increase in social security contributions to statutory health and long-term care insurance relative to their income. Overall, government deficits are expected to improve slightly at –2.4 percent relative to economic output in 2025 compared to the previous year (–2.8 percent) and decline moderately in 2026 to –2.3 percent. Adjusted for economic components and interest payments, there will be a structural primary deficit of –0.6 percent in 2025 and of –0.7 in 2026 relative to potential GDP, following a deficit of –1.1 percent in 2024 (Figure 5).

Overall, price-adjusted GDP in Germany will stagnate in 2025 and expand by 1.1 percent in 2026, partially due to a higher number of work days than in 2025 and a statistical overhang.[9] DIW Berlin is again lowering its forecast for 2025 by 0.2 percentage points and for 2026 by 0.1 percentage points. The forecast has been lowered repeatedly primarily due to the fact that structural and economic challenges are being reflected on the labor market more than was expected. In turn, this burdens private consumption more significantly than was assumed in winter. In light of so much uncertainty, private households are spending less of their rising real disposable income than expected.

A special DIW Berlin study on the effects of the special fund for infrastructure comes to the conclusion that GDP and inflation would be a good two percent and 0.5 percentage points higher on average, respectively, each year over the next ten years.[10] This would result in a growth rate in 2026 that is one percentage point higher than it would have been without the special fund. As it is expected that investment projects require an initial period of planning, approvals, and awarding contracts, 2025 would not be affected.

8 For the challenges facing industrial policy, see Tomaso Duso, Martin Gornig, and Alexander Schiersch, "Wettbewerbsorientierte strategische Industriepolitik als Antwort auf den Investitionsstau in Deutschland," *DIW aktuell* no. 109 (2025) (in German; available online).

9 When adjusted for calender effects, the increase in economic output is only 0.9 percent. The statistical overhang should be 0.4 percentage points for 2026.

10 Dany-Knedlik, Kriwoluzky, and Rieth, "Sondervermögen für Infrastruktur."

Due to ongoing weak investment and declining labor force potential, potential GDP is likely to continue to develop sluggishly. Potential growth is projected to be 0.3 percent in 2029 (Table 5). Labor volume should continue to decline due to the demographic changes. In light of the continuing stagnation of economic output in 2025, the output gap is likely to grow larger and amount to –1.0 percent of potential GDP on average. With the recovery over the coming years, the output gap should then shrink to –0.4 percent in 2026 and close by the end of the medium term in 2029.

Consumer price inflation should continue to decline over the course of the forecast. Following 2.2 percent in 2024, falling energy prices are favoring lower inflation. The ongoing trend of rising food prices, on the other hand, is favoring higher inflation. In particular, the inflation rate of butter and fruit juices is especially high. Overall, DIW Berlin is increasing its inflation forecast for 2025 by 0.1 percentage points to an annual average rate of 2.1 percent. In 2026, inflation should return to the ECB's stability target of two percent. For now, core inflation should remain slightly elevated. Services prices in particular are continuing to rise sharply. Insurance providers, such as car insurance providers, have recently contributed to pricing pressure. Over the further course of the forecast, the core inflation rate should gradually reach the two-percent target and achieve it by the end of 2025.

This forecast is subject to considerable uncertainties: As for the global economy, there are considerable downside risks for the German economy due to US trade policy. This could lead to higher trade barriers for European and German goods than expected, which would primarily weigh on exports from the manufacturing industry. Moreover, there is the risk that geopolitical conflicts could escalate. The previously announced public investment projects in infrastructure and defense represent an upside risk. These projects could lift the German economy, especially industry, out of the recession over the coming years.[11] However, there is a risk that a large share of public funds would result in price increases, as the currently available capacities, especially in civil engineering and defense, are likely to quickly reach their limits. If the ECB has to react to higher prices with interest rate hikes, this would also call debt sustainability into question.

Table 5

Growth of real potential output

Average year-on-year change in percent

	2020–2024	2024–2029
Potential output	0.6	0.3
Contribution to growth		
Labor volume	0.7	−0.1
Capital volume	0.3	0.3
Total factor productivity	0.2	0.2

Note: Differences in the aggregation are due to rounding effects.

Sources: Federal Statistical Office; European Commission; DIW Berlin Economic Outlook Spring 2025.

11 Cf. Dany-Knedlik, Kriwoluzky, and Rieth, "Sondervermögen für Infrastruktur."

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